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CENTRAL INTELLIGENCE AGENCY

REPORT NO. [REDACTED]

INFORMATION REPORT

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SUBJECT Foreign Holdings in Hungary

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25X1X

25X1A

1. With the unexpected nationalization of practically the whole of Hungarian industry at the end of March 1948, the process of adaptation of the Hungarian economy to Soviet requirements entered upon a new and decisive phase. The aims of the Hungarian government, or of those of its members who proposed the decree at a hastily summoned meeting of the Cabinet, were manifold: first, to eliminate all persons still in key positions in industry who were opposed to strict government regimentation and hostile to the Sovietization of Hungarian economy; second, to foster a levelling of social conditions and compensate the low standard of living of the masses by political concessions; and, third, to veil the failure of the government to control the whole economic life of the country, especially industrial production, through the intermediary of the Office for Planning or by other Government agencies, finding at the same time scapegoats for this failure. To understand the causes of these measures, and to realize their probable effects on foreign interests, it is indispensable to make a brief survey of the underlying factors.
2. Hungary is known, in general, as an agricultural country. This classification was suitable for conditions prevailing before World War I; development of industry since then, as expressed by the number of people employed in industry as well as the part played by industrial output in the national revenue, give evident proof of a thorough reversal of the situation.
3. Industry developed in Hungary at a very slow pace until the country formed an economic unit with Austria. The Hungarian plain was the granary of the Austro-Hungarian monarchy, while Hungary derived most of the industrial products she needed from Austria and Bohemia. Notwithstanding these fundamental facts, a slow but steady process of industrial expansion took place in the decades which followed the compromise with Austria (1867). The founding and development of factories to exploit agricultural products (mills, sugar refineries, etc.), was noteworthy, and mention must be made of the iron and steel industry developed in Budapest and the principal mining districts of the country. This process of industrialization, fostered by the Hungarian government and by the strong national feeling of the population, could not, however, absorb the excess rural population.

25X1A

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25X1A

CENTRAL INTELLIGENCE AGENCY

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4. After World War I Hungary was confronted with an entirely new situation. The bonds of the different parts of the Austro-Hungarian monarchy were suddenly severed and the successor-states, aiming at complete economic independence, introduced a strongly restrictive trade policy. Since the old markets for over-priced Hungarian agricultural produces were endangered, Hungary introduced high tariffs in order to protect her infant industries.
5. As the wealthiest members of the population, the feudal landlords, displayed only a minor interest in industry, development of Hungarian industry was left to men from the middle classes, often of foreign origin. When their resources proved insufficient to provide the larger funds needed to run those plants, they were compelled to avail themselves of the large facilities offered by the banks. It was not long before banks acquired substantial holdings in industrial companies, and later on the banks themselves initiated establishment of new industrial companies. The result of this development was that most of the important Hungarian banks controlled a large number of industrial plants, including some of the most important industrial concerns of the country which accounted for a high percentage of total industrial output. The close contact between industry and banking was further strengthened by the fact that independent industrialists very often acquired interests in financial institutions to secure banking services for their companies.
6. The advantage of high tariffs was used, not only by independent industrialists to establish new plants, but also by foreigners and by the banks which held large interests in industry. It was, however, impossible to secure all the funds required by the new investments out of the surplus of current national income; thus, apart from capital imported by foreign concerns, the necessary funds were raised by short and long term foreign loans contracted by the State, municipalities, industrial companies and banks.
7. The crisis of 1929 hit Hungary very severely, for Hungarian economy was affected by the heavy fall in agricultural prices, which increased her tendency to a restrictive policy displayed not only by high tariffs, but also by handling of the exchange control system. Closing of the home market for foreign products and a low wage-level gave a new impetus to the development of industry.
8. The change in the economic character of the country is borne out by foreign trade statistics. Import of finished products, especially consumer goods, decreased constantly, and this shrinkage was only partially compensated by a rise in imports of raw materials, half-manufactured products and machinery. The world economic crisis and the exchange restrictions opened a new era for Hungarian individual industrial ventures, and many industries succeeded in conquering new markets for their products, especially in the Balkans and in the near East.
9. Rearmament, and later, a German drive to integrate Hungary into the German war economy, fostered with vigor after bombing of German industrial centers had increased, helped the country build up an important industry. German aid was particularly valuable in permitting the use of patents and furnishing Hungarian industry with details of German industrial methods and industrial research.
10. German aid was, however, not welcomed with great enthusiasm by all responsible elements; the Government, the National Bank, and others did their best to withstand the German drive to acquire holdings in Hungarian companies. Increasing difficulties which the Germans encountered in furnishing their former markets with goods were exploited by Hungary as a means of further increasing her industrial exports.
11. Thus Hungary entered into the last phase of the second World War with a highly developed industry, including not only the plants and their technical out-fittings, but staffs of experienced specialists, engineers, and skilled labor.

~~CONFIDENTIAL~~

Page 2

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

25X1A

~~CONFIDENTIAL~~

CENTRAL INTELLIGENCE AGENCY

12. The events of the last few months of the war inflicted, however, substantial losses on Hungarian economy, particularly on industry. First, air-raids, then the siege of Budapest were responsible for much damage, principally in buildings. The biggest losses sustained by industry were not a direct result of the acts of war; much valuable equipment was shipped to Germany by the pro-German Hungarian Nazi-Government, and later on, the occupying Russian troops requisitioned and removed machinery, as well as raw material stocks and finished products.
13. The new Hungarian Government, created in Moscow during negotiations for the armistice, started with a very radical land reform which modified the bases of Hungarian agricultural production and had a decisive effect on the agricultural industry. The decree expressly stated the principle of indemnification of former proprietors, but no concrete project to this effect has been published as yet, and nobody has dared to raise this question in public.
14. The new Hungarian Government in general resorted to liberal methods to restore economic life. The work of reorganization and rehabilitation started in the whole country without any administrative measures on the part of the central authorities. Though production was seriously hampered by shortage of equipment and labor, restoring of productive capacity and elimination of economic chaos was achieved by the private initiative of administrators of industrial plants, as well as of the workers, with the aid of the little stocks left on hand. As soon as the scarcity of currency, characteristic of the first months which followed the end of hostilities, was remedied, the National Bank of Hungary, with the consent of the Government, granted credits very freely to re-organize and re-equip industrial plants. With these funds, repaid with extreme ease during the course of an unprecedented inflation, industry was able to adapt itself to new conditions. The very low level of wages helped to re-organize the plants and was responsible for reconquering many former markets. This was done with ease in view of the fact that a great part of Hungarian industry was already operating on VE-Day.
15. At the beginning, Government control was concentrated upon those sectors of economic life which offered special interest to the Russians. Thus, reconstruction of bridges, of the railway-system, of rolling-stock, being of strategical importance, was vigorously pursued. Industrial undertakings working for the Russians, mostly for reparations accounts, received all possible aid which the Hungarian government could offer, and the Russian military commanders, appointed for each of the factories upon the first day of occupation, did their utmost to increase the intensity of work. Governmental aid was, however, calculated only to stimulate production, since financial aid accorded to the industrial companies was compensated by setting of very low prices and by backlogs in payments for deliveries made on orders placed by State agencies.
16. Soon after consolidation of the political situation, a Supreme Economic Council was organized, which exercised, under Communist leadership, a close control over all economic activities of the country. The process of nationalization was begun in the coal-mines only after long debates. The law expressly set forth the rights of the former owners, i.e., the mining companies, to an adequate indemnity and prescribed a fixed term to the Government to submit to Parliament a proper compensation scheme. This has not been done as yet, for the Government has asked and obtained continued deferments of the term.
17. The second phase in the process of nationalization was the taking over by the Government of administration of all heavy industrial plants. The question of ownership was not raised; certain plants operating at a deficit (principally due to inordinately low prices quoted for reparation deliveries) were subsequently run by a newly organized Center for Heavy Industries, with the promise that after fulfillment of all reparation obligations, the plants would revert to the former owners. The formal independence of the companies which originally owned these plants was safeguarded, but they were deprived of all authority, and often new investments

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

25X1A

~~CONFIDENTIAL~~

CENTRAL INTELLIGENCE AGENCY

of questionable advisability from a financial standpoint, were made without consulting the owners.

18. As for the attitude of the Hungarian Government towards the indemnification problem, the case of the Petrosani Colliery Company should be cited. Shares of stock in this most important Rumanian coal mine, situated on territory belonging formerly to Hungary, were owned principally by two Hungarian companies: the Colliery of Salgetarjan and the Colliery of Urikany-Valley of Zsil. Both of these companies are known to have important foreign holdings, particularly the second named company, the shares of which are quoted on the Paris and Geneva Stock Exchange. The Hungarian Government began negotiating with the Soviets with a view to ceding the Petrosani holdings of the two Hungarian companies to Russia for reparation accounts. After long debate, the Russians offered a very low price, which was ultimately accepted by the Hungarian delegates, and the companies were compelled to agree with it. A special law authorized the Government to issue bonds to the two Hungarian companies as indemnity; the payment of interests and amounts for a sinking-fund should have begun on 1 January 1948. Although the amounts required for the purpose were carried on the budget, and the Ministry of Finance gave orders to pay the amounts due, the Supreme Economic Council vetoed the payments with the argument that the necessary amounts do not figure in the scheme of general movement of funds.
19. A measure of far-reaching effect, calculated to seize key-positions within Hungarian economy, was the nationalization of important banks, i.e., the taking-over into State ownership of all holdings in domestic banks of Hungarian nationals, leaving the foreign interests apparently untouched. Because of the part played by the banks in Hungarian industrial life, the administrators nominated by the Government to supervise the activities of financial establishments until their subsequent merger and reorganization, concentrated an immense control of power in their hands. This power was increased when the Government decreed that all companies in which the nationalized banks have a holding of not less than 20% were also subject to State control.
20. The foreign interests involved in these measures were very important, and this procedure did not take into account that the share of foreign capital in Hungarian industrial establishments was extremely large. It is known that after the crisis of 1929 the banks engaged in large-scale re-purchasing of their own shares in the open market. Since this could not be done in their proper names, they used for the purpose their affiliated companies and industrial concerns, thus in fact reducing substantially their own holdings of shares, which reduction was not expressed in the respective balance-sheets. It goes without saying that shares of the banks, which were held by independent or foreign owners, increased in importance through these transactions, although this increase was not expressed either by a higher percentage in share holdings nominally unchanged, nor an increase in voting power. Through nationalization of all such shares held by Hungarian companies, the relative importance of foreign holdings declined to the figures expressed by their shares in the total nominal stocks of the banks and their industrial concerns.
21. The new Central Office of Nationalized Banks failed in its aim of coordinating activities of the financial institutions and industrial establishments now controlled by the State. The months which followed nationalization of the banks were marked by anarchy and incompetence. This was the situation at the end of March 1948 when the Government decreed nationalization of all industrial plants employing more than a hundred workmen; in many cases undertakings of lesser importance, declared by the authorities to be key-plants, fell under the provisions of the new decree. Nationalization consisted in these cases too of forfeiture to the State of all domestic holdings of the companies, but the new administrators appointed by the Government were granted full power, allowing no leeway to foreign holders to exercise any influence on the direction of the companies in which they are interested.

~~CONFIDENTIAL~~~~CONFIDENTIAL~~

Page 4

CONFIDENTIAL

25X1A

CONFIDENTIAL

CENTRAL INTELLIGENCE AGENCY

22. Special emphasis must be laid on the fact that, according to the law of nationalization, former Hungarian citizens who lost their Hungarian nationality since 1931 by acquiring the nationality of another state, are considered for the purpose of the law as Hungarians, i.e., their holdings too are taken over by the State.
23. As for the question of indemnification, the law supports the right of former owners to be indemnified; this will be done, however, only after the finances of Hungary are sufficient to make it possible to raise funds for such indemnity and when commitments arising from previous nationalization or other claims have been settled. The basis of computation for such indemnification is not even mentioned.
24. The interests of foreign holders were apparently considered by preserving intact the old framework of each company. In fact, however, the foreign holder has no possibility to exert the slightest influence upon the management of the companies.
25. The Hungarian Government is doing its best to demonstrate to foreign capitalists the uselessness of maintaining their minority holdings, and has already taken all measures beforehand to have an advantageous basis of computation in the event that the question of cession of foreign holdings should ever be raised. For instance, when all Hungarian companies had to establish new balance-sheets after the stabilization and the introduction of new currency, an authoritative rumor was circulated that a capital levy would soon be assessed on the basis of these new balance-sheets. Accordingly, all assets were computed at an exceedingly low level. Thus, considering the fall in the purchasing power of Hungarian currency since 1 January 1947, for which the new balance-sheets were prepared, we may state that the value of holdings is really a multiple of that expressed in company books.
26. The new organization of industries will further endanger foreign interests. All companies involved in nationalization are now acquiring a new status--they will be organized as "National Establishments". There will be two kinds of such establishments, those in which the state has exclusive interest will be called "State-Owned National Establishments" and those in which State holdings amount to not less than 50% will be "National Establishments with State Interest". State-owned National Establishments are to be organized as companies with unlimited responsibility, while National Establishments with State interest in which the commitments of the State and of other holders are limited to their part of the capital, are to be organized as companies of limited liability. National Establishments will be created by Government patent. The competent cabinet minister will act as chief supervising authority, and will nominate the administrators, managers and general manager. The owners of non-nationalized shares will get certificates, renewable yearly, stating their part in the company. In the event of new capital requirements by the National Establishments, the owners (both the State and the foreign holders) will be called upon to furnish the new funds; if one of the partners fails to make his pro rata contribution, the holdings will be reduced proportionally at the yearly renewal of the certificates.
27. Operation of all industrial plants, whether nationalized or not, is subject to strict regulation. Companies working on similar lines are grouped in industrial centers, and the centers controlling the different sub-divisions of the same branch of economic life are placed under industrial directorates. The centers have administrative responsibilities, while the policy of each branch and the laying-down of programs of production are fixed by the directorates, which are responsible for coordination of the activities of the factories within the economic plan.

CONFIDENTIAL

CONFIDENTIAL

Page 5

~~CONFIDENTIAL~~

CENTRAL INTELLIGENCE AGENCY

CONFIDENTIAL

25X1A

28. The whole system of nationalization, as well as the whole structure of Hungarian regulations of economic activities, is full of ambiguities which serve as a basis for obscuring the real issues and evading any clear liability for indemnifications by the Hungarian government. The shifts of position are calculated to confuse the issue and to put the foreign holders at a complete disadvantage. The Hungarian government will not raise the question of taking over foreign holdings. The tactics are that such proposals should be made by foreign interests, weary of watching the constant dwindling of their holdings without any possibility of fighting against discriminatory measures. The adverse foreign exchange position of Hungary does not make it possible for Hungarian authorities to allot large funds for such purchases. If some of the scattered holders were to start negotiations, it can be assumed that the Hungarian government, through its undisturbed control over industry, will endeavor to drag out such negotiations and to minimize the value of the holdings, unless foreign holders of financial and economic interests of different categories take appropriate steps to create an organization safeguarding their interests possibly on an international basis, on the model of the London "Foreign Bondholders' Committee".

~~CONFIDENTIAL~~~~CONFIDENTIAL~~

Page 6